

COMPONENT B: AUDITOR-GENERAL OPINION 2013/14

6.2 AUDITOR-GENERAL REPORT 2013/14



AUDITOR-GENERAL
SOUTH AFRICA

REPORT OF THE AUDITOR-GENERAL TO THE NORTH- WEST PROVINCIAL LEGISLATURE AND THE COUNCIL OF THE CITY OF MATLOSANA

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the financial statements of the City of Matlosana set out on pages 312 to 370, which comprise the statement of financial position as at 30 June 2014, the statement of financial performance, statement of changes in net assets and cash flow and statement of comparison of budget and actual amounts for the year then ended as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP), the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2013 (Act No. 2 of 2013) (DoRA) and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-general's responsibility

3. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the general notice issued in terms thereof and International Standards on Auditing. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances,



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but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion

Basis for qualified opinion

Housing development fund reserve

6. I was unable to obtain sufficient appropriate audit evidence that management has properly accounted for all revenue transactions relating to the housing development fund reserve in terms of the requirements of section 14(4)(d) of the Housing Act, 1997 (Act No. 107 of 1997), due to the non-availability of accounting records. I was unable to confirm the housing development fund reserve by alternative means. Consequently, I was unable to determine whether any adjustment to the housing development fund reserve of R5 125 928 (2013: R5 125 928) in the financial statements was necessary.

Consumer debtors

7. I was unable to obtain sufficient appropriate audit evidence to verify consumer debtors. The municipality's records did not permit the performance of alternative audit procedures. Consequently, I was unable to determine whether any adjustments to consumer debtors and impairment of receivables of R1 580 750 369 (2013: R1 361 829 998) and R1 504 951 425 (2013: R1 282 972 063) in note 10 to the financial statements were necessary.

VAT receivable

8. VAT included in the impairment of receivables expense was not correctly accounted for in terms of SA Standards of GRAP, GRAP 1, *Presentation of financial statements*. The municipality did not correctly account for VAT transactions and the VAT portion of receivables. Consequently, VAT receivable and accumulated surplus are understated by R63 241 629 and R54 303 612 respectively and operating expenditure is overstated by R22 526 087 (2013: R54 303 612) as well as the consequential impact of R13 588 070 between operating expenditure and property, plant and equipment that could not be quantified as it was impracticable to do so.

Accumulated surplus

9. Limitations placed on the audit of expenditure, revenue transactions and adjustments made to the accumulated surplus in prior years have not been resolved. The municipality's records did not permit the application of alternative audit procedures regarding these transactions. Consequently, I was unable to determine whether any further adjustment relating to accumulated surplus of R5 513 374 790 (2013: R5 852 844 877) as disclosed in the financial statements was necessary. Additionally, the municipality did not correctly account for accumulated surplus in terms of SA Standards of GRAP, GRAP 1, *Presentation of financial statements*. The municipality did not account for assets of R38 771 869 which were not previously recognised in the financial statements. Consequently infrastructure assets are understated by R38 771 869, depreciation understated by R1 596 830 and accumulated



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surplus overstated by R40 368 702 (2013: R41 965 532).

Irregular expenditure

10. Section 125 of the MFMA requires the disclosure of irregular expenditure incurred. The municipality made payments in contravention of the supply chain management requirements that were not included in irregular expenditure, resulting in the understatement of irregular expenditure by R56 866 695. In addition, sufficient appropriate audit evidence could not be provided to substantiate that awards were made in terms of the supply chain management requirements. The municipality's records did not permit the application of alternative procedures. Consequently, I was unable to determine whether any adjustment to irregular expenditure of R1 814 537 200 as disclosed in note 44 to the financial statements was necessary.

Capital commitments

11. During 2013, I was unable to obtain sufficient appropriate audit evidence for capital commitments and to confirm capital commitments by alternative means. Consequently, I was unable to determine whether any adjustment to capital commitments of R112 700 000 as disclosed in note 34 to the financial statements was necessary. My audit opinion on the financial statements for the period ended 30 June 2013 was modified accordingly. My opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures.

Material losses

12. I was unable to obtain sufficient appropriate audit evidence for electricity and water distribution losses disclosed under bulk purchases in note 32 the financial statements as required by section 125(2)(d)(i) of the MFMA. I was unable to confirm the extent of these distribution losses by alternative means. Consequently, I was unable to determine whether any adjustment relating to distribution losses was necessary.

Accumulation of immaterial uncorrected misstatements

13. The financial statements were materially misstated due to the cumulative effect of numerous individually immaterial uncorrected misstatements in the following items making up the statement of financial position:

- Unspent conditional grants reflected as R55 521 713 was understated by R13 389 002
- Trade payables reflected as R329 232 632 are understated by R10 223 641

In addition, I was unable to obtain sufficient appropriate audit evidence and to confirm the following items by alternative means:

- Sundry creditors of R12 349 957 as included in the disclosed balance of R52 281 648



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Qualified opinion

14. In my opinion, except for the possible effects of the matters described in the basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the City of Matlosana as at 30 June 2014 and its financial performance and cash flows for the year then ended, in accordance with SA Standards of GRAP and the requirements of the MFMA and the DoRA.

Emphasis of matters

15. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Unauthorised and fruitless and wasteful expenditure

16. As disclosed in note 42 to the financial statements, unauthorised expenditure of R655 391 203 was incurred in the current year and unauthorised expenditure from prior years of R784 404 168 had not yet been dealt with in accordance with section 32 of the MFMA.
17. As disclosed in note 43 to the financial statements, fruitless and wasteful expenditure of R17 967 226 was incurred in the current year and fruitless and wasteful expenditure from prior years of R36 036 348 had not yet been dealt with in accordance with section 32 of the MFMA.

Going concern

18. As disclosed in the statement of financial performance, the municipality incurred a deficit of R339 470 084 for the year ended 30 June 2014 and, as of that date, the municipality's current liabilities exceeded its current assets by R344 503 182. These conditions, along with other matters as set forth in note 40, indicate the existence of a material uncertainty that may cast significant doubt on the municipality's ability to operate as a going concern.

Additional matters

19. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Unaudited disclosure notes

20. In terms of section 125(2)(e) of the MFMA the municipality is required to disclose particulars of non-compliance with the MFMA. This disclosure requirement did not form part of the audit of the financial statements and accordingly I do not express an opinion thereon.

Unaudited supplementary schedules

21. The supplementary information set out on pages 371 to 380 does not form part of the financial statements and is presented as additional information. I have not audited these schedules and accordingly I do not express an opinion thereon.



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REPORT ON OTHER LEGAL AND REGULARITY REQUIREMENTS

22. In accordance with the PAA and the general notice issued in terms thereof, I report the following findings on the reported performance information against predetermined objectives for the selected development priorities presented in the annual performance report, non-compliance with legislation as well as internal control. The objective of my tests was to identify reportable findings as described under each subheading but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

Predetermined objectives

23. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected development priorities presented in the annual performance report of the municipality for the year ended 30 June 2014:

- Key performance area 1: Service delivery and infrastructure development on pages 129 to 135 and 151 to 176.
- Key performance area 2: Municipal institutional development and transformation on pages 135 to 136 and 176 to 186.
- Key performance area 3: Local economic development on pages 136 to 137 and 187 to 189.

24. I evaluated the reported performance information against the overall criteria of usefulness and reliability.

25. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned development priorities. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's Framework for managing programme performance information (FMPPI).

26. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.

27. I did not raise any material findings on the usefulness and reliability of the reported performance information for the selected development priorities.

Additional matters

28. Although I raised no material findings on the usefulness and reliability of the reported performance information for the selected development priorities, I draw attention to the following matters:

Achievement of planned targets

29. Refer to the annual performance report on pages 128 to 218 for information on the achievement of planned targets for the year.



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Adjustment of material misstatements

30. I identified material misstatements in the annual performance report submitted for auditing on the reported performance information for Key performance area 1: Service delivery and infrastructure development. As management subsequently corrected the misstatements, I did not raise any material findings on the usefulness and reliability of the reported performance information.

Compliance with legislation

31. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

Budgets

32. Expenditure was incurred in excess of the limits of the amounts provided for in the votes of the approved budget, in contravention of section 15 of the MFMA.

Annual financial statements, performance and annual reports

33. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of current assets, liabilities, revenue, expenditure and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a qualified audit opinion.

Audit committees

34. An audit committee was not in place, as required by section 166(1) of the MFMA.

Procurement and contract management

35. Sufficient appropriate audit evidence could not be obtained that all contracts were awarded in accordance with the legislative requirements and a procurement process which is fair, equitable, transparent and competitive, as management has failed to implement a record management system.
36. Quotations were accepted from prospective providers who are not registered on the list of accredited prospective providers and do not meet the listing requirements prescribed by the Supply Chain Management (SCM) policy in contravention of SCM regulations 16(b) and 17(b).
37. Goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a).
38. Sufficient appropriate audit evidence could not be obtained that bid specifications for procurement of goods and services through competitive bids were drafted in an unbiased manner that allowed all potential suppliers to offer their goods or services, as per required by SCM regulation 27(2)(a).



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39. Invitations for competitive bidding were not always advertised for a required minimum period of days, as required by SCM regulations 22(1) and 22(2).
40. Contracts and quotations were awarded to bidders based on points given for criteria that differed from those stipulated in the original invitation for bidding and quotations, in contravention of SCM regulations 21(b) and 28(1)(a) and the Preferential Procurement Regulations.
41. Sufficient appropriate audit evidence could not be obtained that the preference point system was applied in all procurement of goods and services above R30 000 as required by section 2(a) of the Preferential Procurement Policy Framework Act and SCM regulation 28(1)(a).
42. Sufficient appropriate audit evidence could not be obtained that contracts and quotations were awarded to bidders that scored the highest points in the evaluation process, as required by section 2(1)(f) of Preferential Procurement Policy Framework Act.
43. Contracts and quotations were awarded to bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).
44. Awards were made to providers who are in the service of the municipality in contravention of section 112(j) of the MFMA and SCM regulations 44. Furthermore, sufficient appropriate audit evidence could not be obtained that the provider declared that he/she was in the service of the municipality, as required by SCM regulation 13(c).
45. Sufficient appropriate audit evidence could not be obtained that contract and quotations were only awarded to providers whose tax matters have been declared by the South African Revenue Service to be in order as required by SCM regulation 43.
46. The prospective providers list for procuring goods and services through quotations was not updated at least quarterly to include new suppliers that qualify for listing, and prospective providers were not invited to apply for such listing at least once a year as per the requirements of SCM regulation 14(1)(a)(ii) and 14(2).
47. Construction projects were not always registered with the Construction Industry Development Board (CIDB), as required by section 22 of the CIDB Act and CIDB regulation 18.
48. Sufficient appropriate audit evidence could not be obtained that contracts were only extended or modified after tabling the reasons for the proposed amendment in the council of the municipality as required by section 116(3) of the MFMA.
49. Sufficient appropriate audit evidence could not be obtained that the performance of contractors or providers was monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
50. Sufficient appropriate audit evidence could not be obtained that the contract performance and monitoring measures and methods were sufficient to ensure effective contract management, as required by section 116(2)(c) of the MFMA.



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Human resource management and compensation

51. The competencies of financial and supply chain management officials were not assessed in a timely manner in order to identify and address gaps in competency levels as required by the regulation 13 of the Municipal Regulations on Minimum Competency Levels.
52. The municipality did not submit a report on compliance with prescribed competency levels to the National Treasury and relevant provincial treasury as required by regulation 14(2)(a) of the Municipal Regulations on Minimum Competency Levels.

Expenditure management

53. Money owing by the municipality was not always paid within 30 days or an agreed period, as required by section 65(2)(e) of the MFMA.
54. Reasonable steps were not taken to prevent unauthorised expenditure, irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.
55. Payments were made from the municipality's bank account without the approval of the accounting officer, the chief financial officer or a properly authorised official, as required by section 11(1) of the MFMA.

Revenue management

56. An effective system of internal control for debtors was not in place, as required by section 64(2)(f) of the MFMA.
57. Interest was not charged on all accounts in arrears, as required by section 64(2)(g) of the MFMA.

Consequences management

58. Unauthorised, irregular and fruitless and wasteful expenditure incurred by the municipality were not investigated to determine if any person is liable for the expenditure, in accordance with the requirements of section 32(2) of the MFMA.

Waste management

59. The municipality operated its wastewater treatment facilities without a license in contravention of section 20(b) of the National Environmental Management Waste Act, 2008 (Act No. 59 of 2008) (NEMWA), section 24(2)(a) of the National Environmental Management Act, 1998 (Act No. 107 of 1998) (NEMA) and section 22(1)(b) of the National Water Act, 1998 (Act No. 36 of 1998) (NWA).
60. The municipality's operational activities at its waste disposal sites and wastewater treatment facilities contravened or failed to comply with the requirements of a waste management license, section 67(1)(f) and (h) of the NEMWA and section 151(1)(c) and (i) of the NWA.
61. The municipality's waste management and disposal activities contravened or failed to comply with the requirements of section 28(1) of the NEMA, section 19 of the NWA and sections 16(1)(c) and (d) and 26(1)(b) of the NEMWA.



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62. The municipality did not exercise its legislative and executive authority as required by section 11(3)(l) and (m) of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA) by managing, monitoring and enforcing environmental related bylaws to promote a safe and healthy environment.

Internal control

63. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for qualified opinion, the findings on the annual performance report and the findings on non-compliance with legislation included in this report.

Leadership

64. The leadership has not been able to enforce a culture of honesty, ethical business practices and good governance. Although resolutions adopted by Council to address prior year audit findings had an impact on the audit outcomes, the implementation thereof was mostly done through consultants. The sustainability of the improvements remains a challenge given the vacancies and appropriate skill deficiencies that exist in the finance section.

Financial and performance management

65. Management's continuous failure to comply with laws and regulations as well as their inability to implement controls to ensure reliable and accurate financial reporting, is a concern. This factor, as well as the continuous non adherence with the supply chain management policy without consequences reflects negatively on management's commitment towards a clean administration.

Governance

66. The risks which emanated from the prior year audit report were not addressed through the implementation of the risk management strategy adopted by the municipality. The audit committee did not exist for a greater part of the financial year, resulting in the internal control environment over financial information and compliance with laws and regulations being ineffective.

Auditor General

Rustenburg
30 November 2014



AUDITOR-GENERAL
SOUTH AFRICA

Auditing to build public confidence